Reform 4.9: Explore Changing Pensionable Status of Special Pays

To enhance the freeze and/or reduction in "pensionable pay," and perhaps achieve even better savings than represented in the bar graph above, the City can also seek to negotiate the "pensionable" status of a number of "specialty pays."

Our office has identified at least $13 million in special pays that are currently considered pensionable that may be legal candidates for conversion to "non-pensionable" status in the coming year.

In these cases, the City may have an opportunity to reduce pensionable payroll (thus achieving actuarial savings long term in the pension system.)

Our office has inquired as to the legal ability of the City to pursue such a strategy, and it is our understanding that the majority of special pays can be either eliminated or restructured in such a way as to reduce the number that have "pensionable" status.

The Roadmap for Reform calls on the City to explore the potential for pensionable status reform of special pays, and we recommend the city labor negotiating team tackle at least 10 special pays prior to commencement of FY 2012, including all Bilingual Pays (Excluding Police), Hose Repair Pay, Ladder Repair Pay, and Dispatch Cert Pay.

(NOTE: For a more exhaustive discussion on special pays, see Commitment 5: Reform City Salaries and Labor Contracts.)

Reform 4.10 Transition to Affordable Pension Plans

The current level of pension benefits are not only unaffordable to city taxpayers, but may be also unaffordable to city employees – in the event that city employees are required to pay a fair share of the cost of the benefits.

That's why the Roadmap to Recovery proposes the establishment of additional pension tiers and options for city employees:

Defined Contribution Plan
The city should immediately provide a simple 401(k) plan to all new hires and offer existing employees the ability to "freeze" their current pension benefit levels by leaving the system and enrolling in the 401(k) plan immediately.

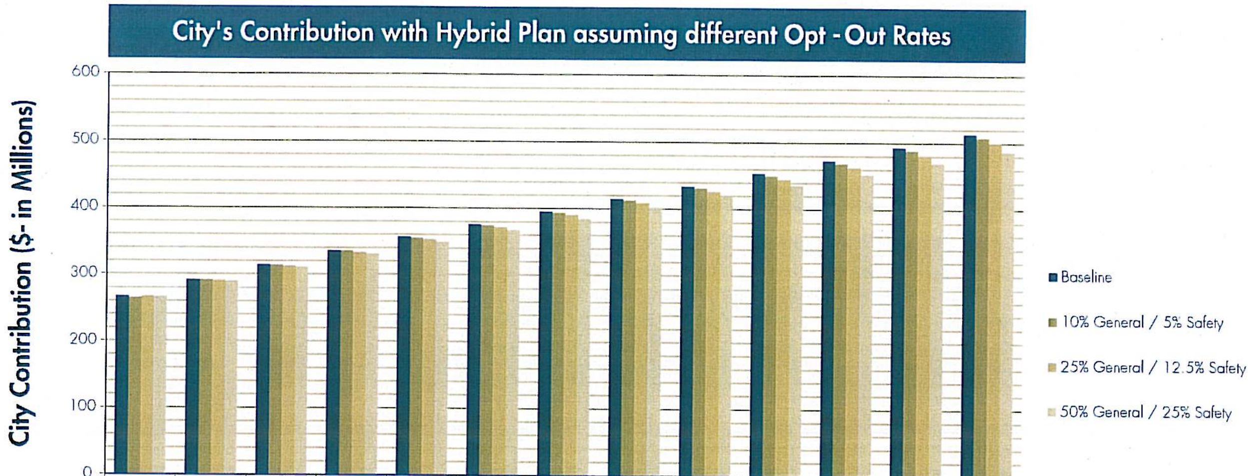
DB-DC Hybrid Plans
The General classification employees already have a hybrid pension plan that is more affordable. Police Officers have a lower tier defined benefit plan, but it is still quite costly. Under Prop D Firefighters were expected to receive a plan similar to the one created for POA. The Roadmap to Reform believes a more affordable hybrid plan should be offered to Police and Fire employees.

In addition to creating these more affordable hybrid plans for new employees, the city should adopt the policy to allow all existing employees to downgrade from higher tier to these lower tiers.

Implementation of this policy will have to await final approval from the Internal Revenue Service.

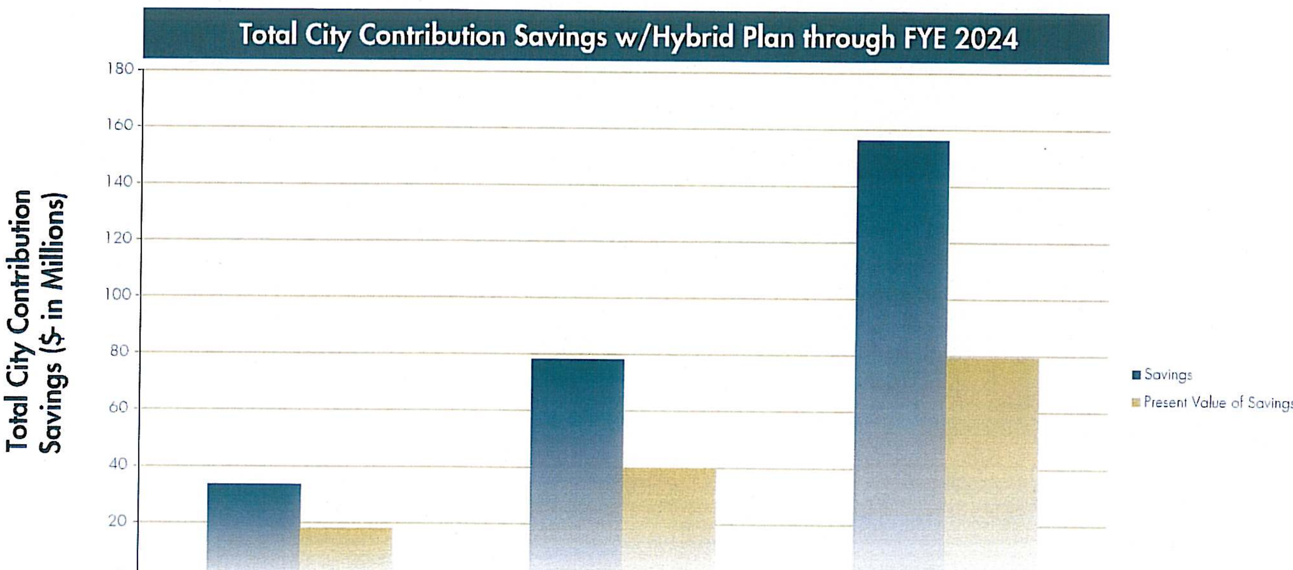
We also obtained an actuarial analysis of a potential "opt-out" program, where City employees would leave the current system and opt into a hybrid, where a Defined Benefit reduced by 50% was packaged with a 5% defined contribution match.

Different take-up rates for public safety and general employees were assumed, with the potential savings from such a program under three different take-up scenarios shown on the next page:



	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Baseline	267	292	315	336	357	376	396	415	434	454	473	493	514
10% General / 5% Safety	265	291	314	335	355	375	394	413	431	450	469	489	508
25% General / 12.5% Safety	267	291	313	333	353	372	390	409	427	445	463	482	500
50% General / 25% Safety	266	289	311	331	349	367	385	402	419	436	453	470	487

Fiscal Year End



	10% General / 5% Safety	25% General / 12.5% Safety	50% General / 25% Safety
Savings	34	78	156
Present Value of Savings	18	40	79

Assumed Opt-Out Rate

Reform 4.11: Continue SPSP Waiver Process
Beginning in FY 2013, we recommend inplementing a SPSP waiver or commensurate compensation reduction for remaining bargaining units with the benefit.

Reform 4.12: Adopt Total Net Compensation Model for Each Classification
Once "pensionable pay" is reduced and capped for the five year period, and in preparation for the "opt-out" pension reform plan, The City should explore whether an amendment Charter Section 130 is needed in order to adopt a "net compensation" model for city employee classifications.

A total sum of compensation for each city classification would be provided, along with a standard "benefits allowance" that provides for all fringe benefits (including pension costs).

Employees in the higher pension benefit level will see less take-home pay than employees in lower, more affordable pension benefit levels.

The net compensation model is not only designed to provide greater financial incentives to city employees to voluntarily "opt-out" of higher pension tiers, but is also explicitly designed to address the Generational Inequity that has been created within the city workforce where some city employees receive greater compensation with higher benefits at the expense of other employees with lower benefit packages.

Reform 4.13: Explore Benefit from Requiring City Employees to Share Equally in Pension Investment Risks [15]
The analysis shows that the City stands to gain potentially gain from a sharing of investment losses.

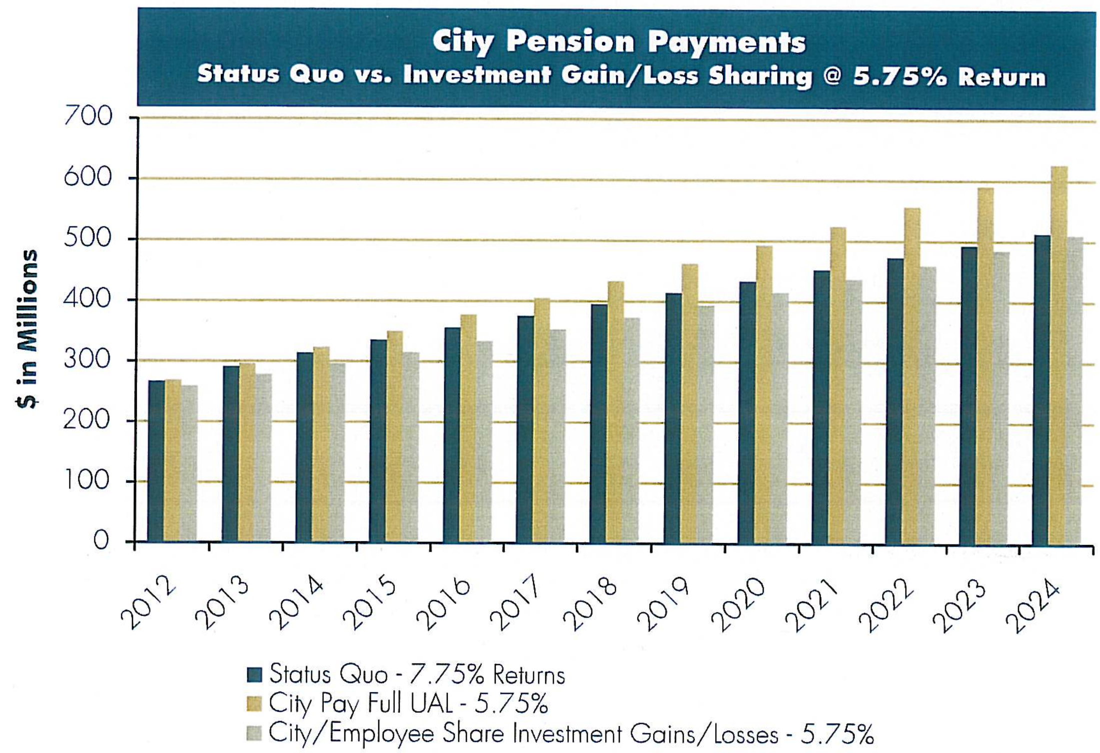
This reform – known as "Sub-Equal for Investment Gains/Losses" – was originally raised by the Pension Reform Committee in 2004 and has been raised consistently by our office. In spring of 2010, City Attorney Jan Goldsmith, with the support of the City Council, brought suit against SDCERS over this issue.

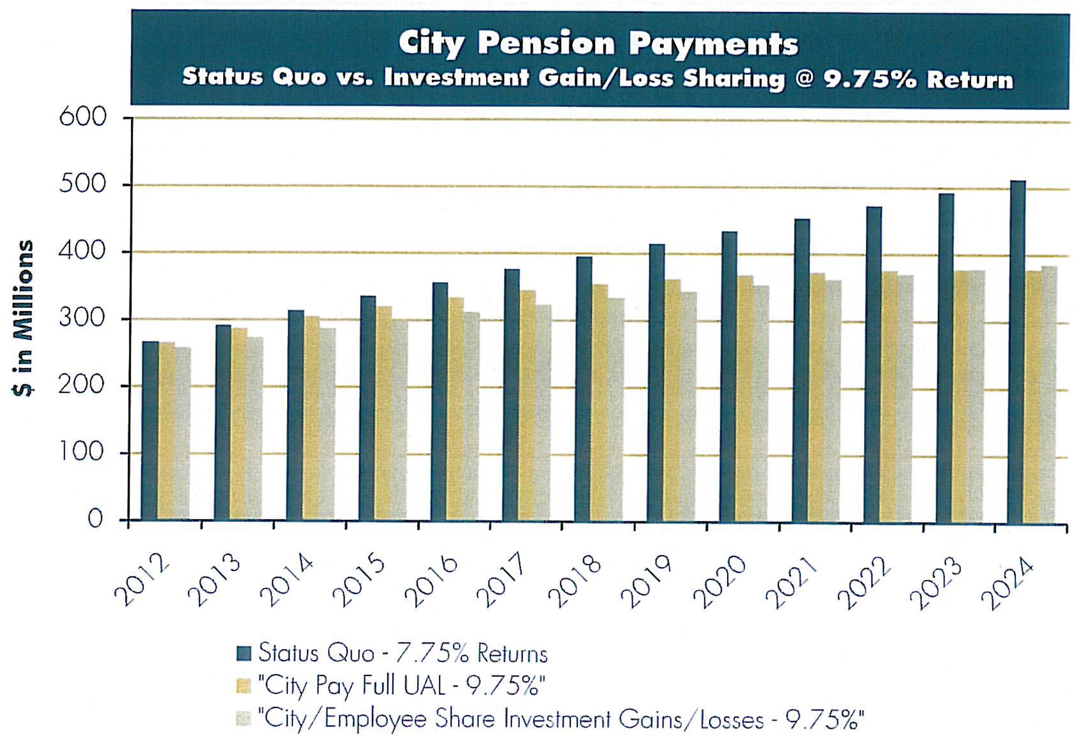
SDCERS has "argued that in a defined benefit plan the employer is generally responsible for the unfunded actuarial accrued liability." However, in her Tentative Ruling, Judge Joan M. Lewis has stated that "[i]n this case, the City's Charter and, specifically, Section 143 contains language requiring the City to contribute only an amount 'substantially equal' to that required of the employees for normal retirement allowances, as certified by the actuary, but shall not be required to contribute in excess of that amount, except in case of financial liabilities accruing under any new retirement plan or revised retirement plan because of past service of the employees."

As such, she "reject[ed] the argument that as a matter of law and with what is before [the Court] at this time, the City must entirely fund the UAL."

We obtained an actuarial model of various investment return assumptions, as well as the impact of sharing investment losses/gains between the City and employees, beginning July 1, 2001. We obtained this modeling due to the legal actions being currently pursued by the City to force SDCERS to apply "substantially equal" contributions to investment experience.

[15] Legal references in this section refer to City of San Diego vs. San Diego City Employees Retirement System. Case No: 37-2010-00091207-CU-WM-CTL


City Pension Payments
Status Quo vs. Investment Gain/Loss Sharing @ 5.75% Return
$ in Millions
700
600
500
400
300
200
100
0
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
Status Quo - 7.75% Returns
City Pay Full UAL - 5.75%
City/Employee Share Investment Gains/Losses - 5.75%


City Pension Payments
Status Quo vs. Investment Gain/Loss Sharing @ 9.75% Return
$ in Millions
600
500
400
300
200
100
0
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
Status Quo - 7.75% Returns
"City Pay Full UAL - 9.75%"
"City/Employee Share Investment Gains/Losses - 9.75%"

It is important to note that the possibility that City employees were not contributing adequately (adequately is used here to refer to contributions as required by the Charter) to the pension system was raised as early as 2004 in the Pension Reform Committee "Final Report."[16] Some of the initial progress that has been made resulted in an approximate $2 million reduction in the City's ARC payment paid on July 1, 2010 as determined by the revised June 30, 2009 actuarial valuation, which followed the SDCERS Board adoption of new contribution rates at its May 28, 2010 meeting.[17]

While the ultimate resolution of this case is still to be determined, the notion that investment losses are not the entire responsibility of the City due to the City Charter has not been dismissed. Given the remaining uncertainty, however, we do not apply any potential savings from investment gain/loss sharing to the FY 2012 budget.

Nevertheless, as the City seeks to reduce its long-term pension costs to free up finite General Fund revenues for service provision, this looming possibility may help to bolster the viability of the options explored further below due to the increased negotiating leverage gained as a result of the potential Charter-required increase in contribution rates for City employees.

Reform 4.14: Seek "Negotiated Settlement" on Pension Reform from City Labor Unions Using City Charter Section 143.1

While this office has on multiple occasions suggested that an amendment to the City Charter section 143.1-employee vote requirement be explored [18,19], this Charter section may also provide a unique opportunity to reduce the City's pension liability.

As familiarly triggered, the section provides members of the retirement system with an effective veto power over changes to benefit levels, despite the outcome of the "Meet and Confer" process.Charter section 143.1 states, in part, that:

> *"No ordinance amending the retirement system which affects the benefits of any employee under such retirement system shall be adopted without the approval of a majority vote of the members of said system."*

In addition to the de facto veto power over benefit changes granted to system members, this provision may provide a unique legal mechanism for changing the benefits of existing employees – a pension reform typically viewed as "off the table" due to the nature of vested benefits.[20]

As the fiduciary counsel for SDCERS has pointed out [21],

> *"One of the premises of vested rights is that the contractual right is determined based on the terms of the contract at the time that the person began working. And in the case of that contract has included since 1954, the benefit vote provision section 143.1. Therefore, the vested rights to particular retirement benefits that are provided with and in the City of San Diego (the SDCERS plan) are all subject to the possibility of modification on the appropriate vote as to the members...What we addressed in our analysis is simply the active members' rights to take away from themselves a benefit that was previously granted."*

We reference this Charter provision to remind city labor unions that, according to SDCERS counsel, they can always utilize this provision to offer their own pension reform plan using Charter Section 143.1.

Reform 4.15: Achieve Pension Savings from Downsizing and Managed Competition

Fiscal reforms implemented to balance the FY 12 budget will also pay dividends when it comes to the city's long-term pension costs. To capture those savings, we obtained an actuarial analysis of the impact of a reduction-in-force for the general membership group of employees.

16 See Pension Reform Committee "Final Report." pg 45 of 74 as an example.
17 See Revised June 30, 2009 SDCERS Actuarial Valuation, Letter of Transmittal.
18 "Legal Review of Possible Pension Reform Ideas." December 4, 2009.
19 "Amending the City Charter to Facilitate Pension Reform." January 4, 2010.
20 "Pension Benefits and Other Post-Employment Benefits." City Attorney Opinion Number 2010-1. January 21, 2010.
21 Testimony from Ashley Dunning (Manatt, Phelps & Phillips) transcribed from SDCERS Board of Administration meeting of August 20, 2010.

Given the City's apparent forthcoming efforts to subject functions to managed competition, as well as the City's legal ability to directly outsource service functions outside of the process set forth in the Managed Competition Guide [22,23], the impact to the City's annual pension payment from reducing the number of employees is important to understand and quantify.

The impact of 10%, 20% and 30% reductions-in-force, each equally phased-in over three years, is displayed in the tables at the end of this section.

This reduction in force only applies to non-public safety members, and is intended to show the impact that the City can expect to its pension payment from various degrees of workforce downsizing.

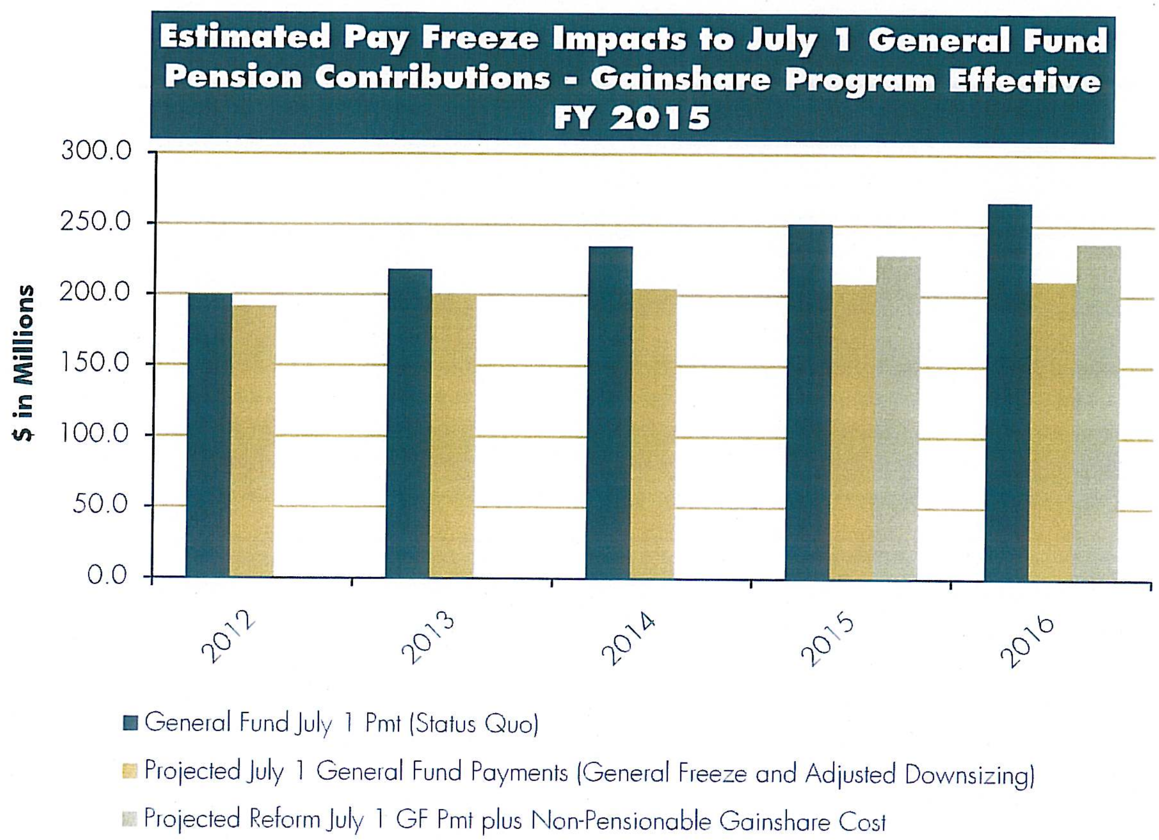
Reform 4.16: Implement a Pension Reform "Share-in-Savings" Program for City Employees

The Roadmap to Recovery recognizes that salary freezes are a major part of the financial recovery process – and those freezes will impact our city employees. To provide gain-sharing for city employees – and to offset years of salary freezes – the Roadmap proposes the creation of a "Share-in-Savings" pool to provide non-pensionable bonuses to city employees based on documented savings from pension reform.

Beginning in FY 15, the gain-sharing program would offer a performance-based, non-pensionable pay bonus. This bonus would be equal to 50% of the pension savings achieved in the FY 2015 ARC. These savings would be required to be attributable solely to cost savings from reforms (e.g. not from potential actuarial gains due to investment experience).

To provide proper accountability and oversight, the SDCERS actuary and City Auditor would be responsible for certifying that the savings attributable to the freeze in that year's payment were, in fact, the result of the pay freeze reforms. The employee bonuses would be available for distribution among City employees through a measurement methodology to-be-determined in negotiations that would reward exceptional performance.

In our Five Year forecast, we begin to share the reform gains with employees through this system in FY 2015.



[22] See City of San Diego "Managed Competition Guide." July 26, 2010, pg. 1.
[23] See City Attorney Legal Opinion Number 2009-2.

FY	Baseline Projection	Pay Freeze Savings	Downsizing Savings	Gain Share (Non-Pensionable Bonus)	Net Pmt + Bonus	Net General Fund Savings
2012	$200.0	($8.1)	$0.0	$0.0	$191.9	($8.1)
2013	$218.3	($18.0)	($0.0)	$0.0	$199.4	($18.9)
2014	$235.3	($28.8)	up to ($0.9)	$0.0	$204.9	($30.4)
2015	$251.3	($40.7)	up to ($1.6)	$20.4	$229.0	($22.3)
2016	$266.6	($53.8)	up to ($1.9)	$26.9	$237.8	($28.9)

All payments are adjusted to reflect the General Fund portion paid in full on July 1 of each year.

Detailed Actuarial Tables on Impact of Pension Reforms

Chart 1: Freeze in "Pensionable Pay"
As the actuarial analysis shows, the City has the ability to significantly reduce its annual pension payment and achieve annual General Fund savings by holding the line on salary increases.

FY	Baseline Projections				Hard Pay Freeze - 4% Entry Age Normal Savings Assumed				Projected General Fund (Savings)
	Citywide			General Fund	Citywide			General Fund	
	Mid-Year Pmt	% of Payroll	July 1 Pmt	July 1 Pmt	Mid-Year Pmt	% of Payroll	July 1 Pmt	July 1 Pmt	
2012	267.4	45.18%	257.1	200.0	251.6	46.89%	241.9	188.2	(11.8)
2013	291.9	47.41%	280.6	218.3	262.8	48.98%	252.7	196.6	(21.7)
2014	314.6	49.14%	302.4	235.3	271.1	50.51%	260.5	202.7	(32.6)
2015	336.0	50.46%	323.0	251.3	276.6	51.54%	265.8	206.8	(44.5)
2016	356.5	51.48%	342.7	266.6	279.6	52.11%	268.8	209.1	(57.5)
2017	376.4	52.26%	361.8	281.5	280.4	52.25%	269.5	209.7	(71.8)
2018	395.9	52.85%	380.5	296.1	279.0	52.00%	268.2	208.7	(87.4)
2019	415.2	53.30%	399.1	310.5	275.5	51.34%	264.8	206.0	(104.5)
2020	434.4	53.62%	417.6	324.9	269.9	50.29%	259.4	201.8	(123.1)
2021	453.8	53.85%	436.2	339.3	262.1	48.84%	251.9	196.0	(143.3)
2022	473.3	54.01%	455.0	354.0	252.1	46.98%	242.3	188.5	(165.5)
2023	493.3	54.12%	474.1	368.9	239.8	44.68%	230.5	179.3	(189.6)
2024	513.6	54.19%	493.7	384.1	225.0	41.92%	216.2	168.2	(215.9)

Notes: $ are presented in millions

June 30, 2009 actuarial valuation (published January 2010) utilized for analysis.

Chart 2: Impact on Annual Pension Payment from 10-30% Downsizing of City Workforce

FY	Baseline Projections				10% General Reduction-in-Force (3-Year Phase-In)				Projected General Fund (Savings)
	Citywide			General Fund	Citywide			General Fund	
	Mid-Year Pmt	% of Payroll	July 1 Pmt	July 1 Pmt	Mid-Year Pmt	% of Payroll	July 1 Pmt	July 1 Pmt	
2012	267.4	45.18%	257.1	200.0	265.8	46.33%	255.5	198.8	(1.2)
2013	291.9	47.41%	280.6	218.3	289.1	49.47%	277.9	216.2	(2.1)
2014	314.6	49.14%	302.4	235.3	311.2	51.71%	299.2	232.7	(2.5)
2015	336.0	50.46%	323.0	251.3	332.5	53.13%	319.6	248.7	(2.6)
2016	356.5	51.48%	342.7	266.6	352.9	54.22%	339.2	263.9	(2.7)
2017	376.4	52.26%	361.8	281.5	372.6	55.05%	358.2	278.7	(2.8)
2018	395.9	52.85%	380.5	296.1	392.0	55.68%	376.8	293.2	(2.9)
2019	415.2	53.30%	399.1	310.5	411.2	56.16%	395.3	307.5	(3.0)
2020	434.4	53.62%	417.6	324.9	430.3	56.51%	413.6	321.8	(3.1)
2021	453.8	53.85%	436.2	339.3	449.5	56.76%	432.1	336.2	(3.2)
2022	473.3	54.01%	455.0	354.0	469.0	56.94%	450.8	350.7	(3.3)
2023	493.3	54.12%	474.1	368.9	488.8	57.06%	469.8	365.5	(3.4)
2024	513.6	54.19%	493.7	384.1	509.0	57.14%	489.3	380.7	(3.5)

Note: $ are presented in millions

June 30, 2009 actuarial valuation (published January 2010) utilized for analysis

FY	Baseline Projections				20% General Reduction-in-Force (3-Year Phase-In)				Projected General Fund (Savings)
	Citywide			General Fund	Citywide			General Fund	
	Mid-Year Pmt	% of Payroll	July 1 Pmt	July 1 Pmt	Mid-Year Pmt	% of Payroll	July 1 Pmt	July 1 Pmt	
2012	267.4	45.18%	257.1	200.0	264.2	47.54%	253.9	197.6	(2.4)
2013	291.9	47.41%	280.6	218.3	286.5	51.63%	275.4	214.3	(4.0)
2014	314.6	49.14%	302.4	235.3	308.0	54.44%	296.1	230.4	(4.9)
2015	336.0	50.46%	323.0	251.3	329.2	55.95%	316.5	246.2	(5.1)
2016	356.5	51.48%	342.7	266.6	349.5	57.11%	336.0	261.4	(5.3)
2017	376.4	52.26%	361.8	281.5	369.1	58.00%	354.8	276.1	(5.4)
2018	395.9	52.85%	380.5	296.1	388.4	58.68%	373.3	290.5	(5.6)
2019	415.2	53.30%	399.1	310.5	407.4	59.19%	391.7	304.7	(5.8)
2020	434.4	53.62%	417.6	324.9	426.5	59.57%	409.9	318.9	(6.0)
2021	453.8	53.85%	436.2	339.3	445.5	59.84%	428.3	333.2	(6.1)
2022	473.3	54.01%	455.0	354.0	464.9	60.04%	446.9	347.7	(6.3)
2023	493.3	54.12%	474.1	368.9	484.6	60.17%	465.8	362.4	(6.5)
2024	513.6	54.19%	493.7	384.1	504.7	60.26%	485.1	377.4	(6.7)

Note: $ are presented in millions

June 30, 2009 actuarial valuation (published January 2010) utilized for analysis.

FY	Baseline Projections				30% General Reduction-in-Force (3-Year Phase-In)				Projected General Fund (Savings)
	Citywide			General Fund	Citywide			General Fund	
	Mid-Year Pmt	% of Payroll	July 1 Pmt	July 1 Pmt	Mid-Year Pmt	% of Payroll	July 1 Pmt	July 1 Pmt	
2012	267.4	45.18%	257.1	200.0	262.6	48.79%	252.4	196.4	(3.6)
2013	291.9	47.41%	280.6	218.3	284.0	53.89%	273.0	212.4	(5.9)
2014	314.6	49.14%	302.4	235.3	305.1	57.31%	293.2	228.1	(7.1)
2015	336.0	50.46%	323.0	251.3	326.2	58.92%	313.5	243.9	(7.4)
2016	356.5	51.48%	342.7	266.6	346.3	60.15%	332.9	259.0	(7.6)
2017	376.4	52.26%	361.8	281.5	365.9	61.10%	351.7	273.6	(7.9)
2018	395.9	52.85%	380.5	296.1	385.0	61.83%	370.1	287.9	(8.1)
2019	415.2	53.30%	399.1	310.5	404.0	62.38%	388.3	302.1	(8.4)
2020	434.4	53.62%	417.6	324.9	422.9	62.78%	406.5	316.3	(8.6)
2021	453.8	53.85%	436.2	339.3	441.9	63.08%	424.7	330.4	(8.9)
2022	473.3	54.01%	455.0	354.0	461.1	63.29%	443.2	344.8	(9.2)
2023	493.3	54.12%	474.1	368.9	480.6	63.44%	462.0	359.5	(9.4)
2024	513.6	54.19%	493.7	384.1	500.7	63.54%	481.3	374.4	(9.7)

Note: $ are presented in millions

June 30, 2009 actuarial valuation (published January 2010) utilized for analysis

Chart 3: Shifting Investment Risk with "Substantially Equal" Mandate

The chart below shows the impact of a simplistic assumption that any increase in the SDCERS rate has an equal impact on both the City and the employee rate – at various rates of investment returns. (It should be noted, however, that the employee rate would need to be slightly adjusted to reflect that a change in employee contributions will have an impact on potential refunds of employee contributions.)

FY	Current Assumptions, (7.75%)	City Pay (5.75%)	City Share (5.75%)	(Savings) Due to Sharing Investment Losses (5.75%)	City Pay (9.75%)	City Share (9.75%)	(Savings) Due to Sharing Investment Losses (9.75%)
2012	267.4	269.0	259.5	(9.5)	265.8	257.9	(7.9)
2013	291.9	296.5	278.1	(18.4)	287.2	273.4	(13.8)
2014	314.6	323.6	296.6	(27.0)	305.4	287.5	(17.9)
2015	336	350.5	315.3	(35.2)	320.9	300.4	(20.5)
2016	356.5	377.7	334.2	(43.5)	334.1	312.4	(21.7)
2017	376.4	405.4	353.7	(51.7)	345.2	323.6	(21.6)
2018	395.9	433.7	373.7	(60.0)	354.5	334.1	(20.4)
2019	415.2	463.0	394.3	(68.7)	362.1	343.9	(18.2)
2020	434.4	493.2	415.7	(77.5)	368.2	353.2	(15.0)
2021	453.8	524.6	437.8	(86.8)	372.7	361.9	(10.8)
2022	473.3	557.2	460.8	(96.4)	375.8	370.1	(5.7)
2023	493.3	591.4	484.9	(106.5)	377.5	377.9	0.4
2024	513.6	627.0	509.9	(117.1)	377.9	385.3	7.4

*All payments are adjusted to reflect the General Fund portion paid in full on July 1 of each year.

**We have estimated downsizing savings as 75% of the savings projected by our actuary, as well as lagged the savings by two years to reflect procedural delays in Managed Competition. The studies we obtained examined savings from each of these reforms in isolation. Thus, their impact cannot simply be added together to produce accurate projections. Further, we purposely applied the more conservative pay freeze estimates we obtained. An actuarial analysis would need to be performed that assumed both of the reforms were taking place simultaneously to arrive at a more precise figure.